

# AUSTRALIAN MARKETS WEEKLY

## *Business investment held back by machinery and equipment*



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### Analysis – Business investment held back by unprecedented weakness in machinery and equipment

- Business investment is exceptionally weak at present, only slightly above the multi-decade low reached as a share of GDP in the early 1990s recession. Some of this weakness reflects the end of the construction phase of the mining boom, as well as the structural decline in farm investment, where there has been an added drag from a devastating drought.
- However, non-mining/farm investment is also very weak, held back by machinery and equipment, which has languished at a multi-decade low after a deep slump during the global financial crisis. Our analysis shows that this weakness is broadly based across the main types of capital goods and by industry.
- The depth, breadth and persistence of the weakness in machinery and equipment is unprecedented in the post-WW2 period. We think a turnaround in investment requires a sustained recovery in consumer-led demand, although the government could assist via tax incentives. That looks on the table for next year's budget, albeit constrained by the government's objective of reaching a budget surplus.

### The week ahead – RBA on hold, RBA agreement and forecasts; NZ labour market

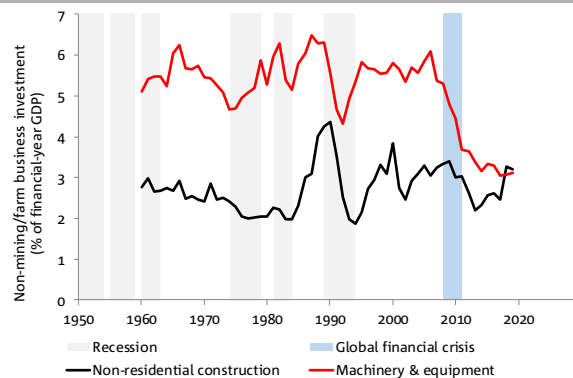
- In Australia, the Reserve Bank is expected to keep the cash rate unchanged at 0.75% and retain an easing bias on Tuesday (consensus: 0.75%; market pricing: 0.74%). The bank is also expected to release an updated Statement on the Conduct of Monetary Policy, which is the agreement with the government on policy. We expect the statement will retain the 2-3% inflation target and likely introduce a BoE-style requirement of a public explanation when inflation has missed the target. Less clear is whether it will emphasise the midpoint of the target or extend to unconventional monetary policy. Friday's Statement on Monetary Policy should downgrade the bank's near-term growth forecasts. The outlook for inflation and unemployment should be unchanged, although the bank might trim its unemployment profile. In NZ, we expect the unemployment rate to edge up to 4.1% from 3.9% and annual growth in the private ordinary-time LCI to pick up to 2.4% from 2.2%.
- Internationally, the BoE is expected to remain on hold, with the market focused on political opinion polls that currently point to either a Tory win or a hung Parliament. Globally, the focus remains on the US-China trade war.

### Key markets over the past week

	Last	% chg week		Last	bp/% chg week
AUD	0.6919	1.2	RBA cash	0.75	0
AUD/CNY	4.86	0.8	3y swap	0.89	7
AUD/JPY	74.9	0.5	ASX 200	6,683	-0.9
AUD/EUR	0.620	0.6	Iron ore	81	-2.6
AUD/NZD	1.072	-0.5	WTI oil	55.9	0.1

Source: Bloomberg

### Chart of the week: Equipment investment languishes



## Business investment held back by unprecedented weakness in machinery and equipment

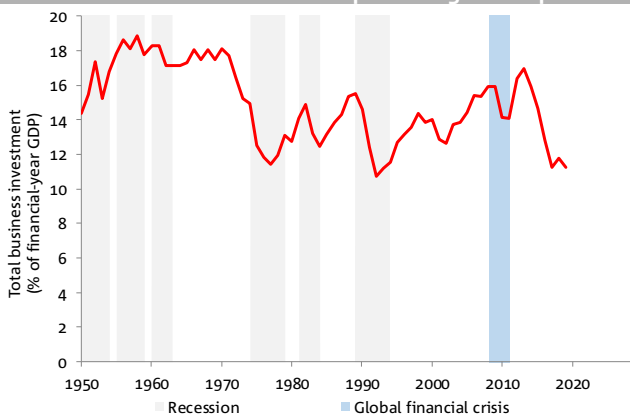
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### Business investment is extremely weak

Revisiting work in a recent weekly, we have looked more closely at the weakness in business investment using the recently-released annual national accounts, which provides the most detailed picture of spending by business.

At an aggregate level, business investment is exceptionally weak, with total investment in 2018-19 back at 11.2% of GDP, unwinding a small improvement the previous financial year. To place this in perspective, investment is only slightly above the 10.7% low reached in the early 1990s recession, when capex reached the lowest point since the late 1940s.

Chart 1: Business investment is plumbing the depths



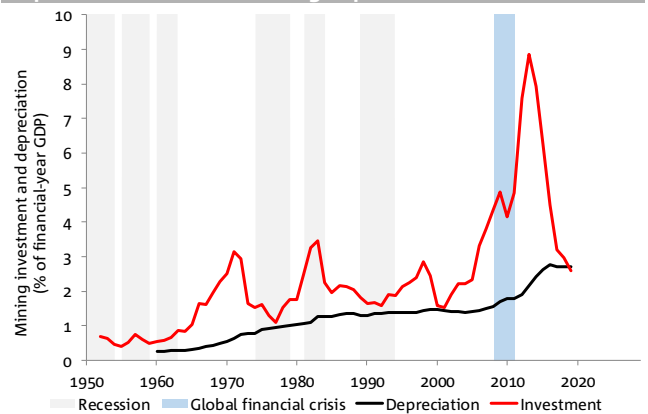
Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

## Some of the weakness reflects the end of the mining construction boom ...

The weakness in business investment partly reflects the end of the construction phase of the mining boom. During that boom, mining investment reached 8.9% in 2012-13, which was the largest expansion in Australia's history.

Mining investment has fallen to 2.6% of GDP in 2018-19, which is above the 1.5-1.9% range prevailing prior to the boom, but is marginally below 2.7% of GDP depreciation on the now-larger capital stock. This points to the need to lift investment to keep pace with the wear and tear on existing mines and related infrastructure.

Chart 2: Mining investment has fallen below depreciation on the existing capital stock



Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

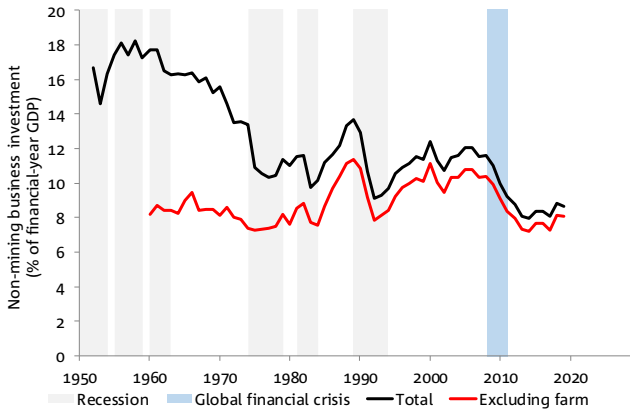
## ... although non-mining business investment is also depressed

Outside the resources sector, business investment is also weak. Non-mining investment reached a multi-decade low of 8.0% of GDP in 2013-14 and its share of output is currently 8.6%, which is below past recession lows.

However, the historical comparison is distorted by the trend decline in farm investment from almost 10% of GDP in 1959-60 to a record low of 0.6% in 2018-19. The current low level of investment is partly due to the severe drought over much of the east coast of Australia, while the structural decline reflects progressively less investment in "cultivated biological resources", which covers farmed livestock, orchards, etc.

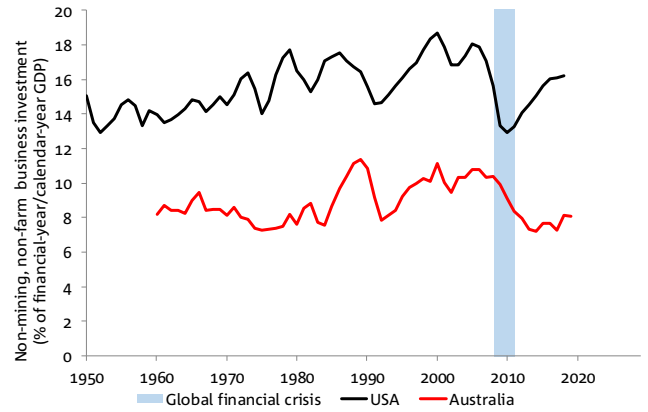
Excluding agriculture, non-mining business investment fell from a pre-global financial crisis level of 10.3% of GDP to a multi-decade low of 7.2% in 2013-14. Investment has since recovered to 8.1% of output, which is only fractionally above the low reached in the early 1990s recession. This is remarkable considering the severity of the early 1990s recession reflected businesses repairing their balance sheets after the debt-driven commercial property boom of the late 1980s.

Chart 3: Non-mining business investment is at multi-decade lows ...



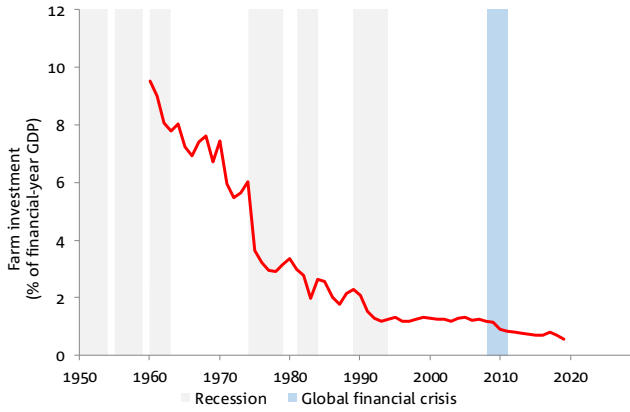
Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

Chart 5: Australian investment is weak by world standards



Note: US data are on a calendar-year basis.  
Source: Australian Bureau of Statistics, Bureau of Economic Analysis, National Australia Bank

Chart 4: ... where historical comparisons are distorted by the trend decline in farm investment



Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

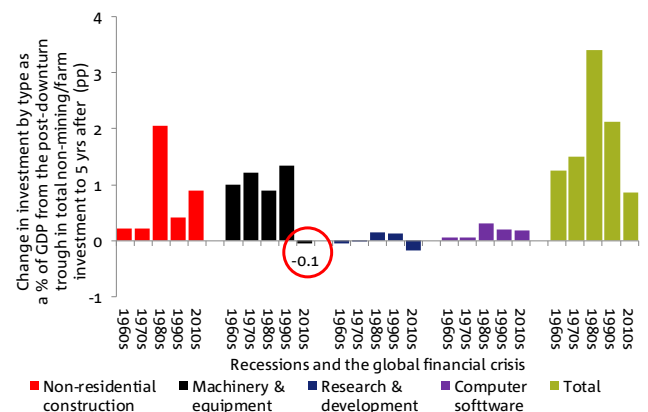
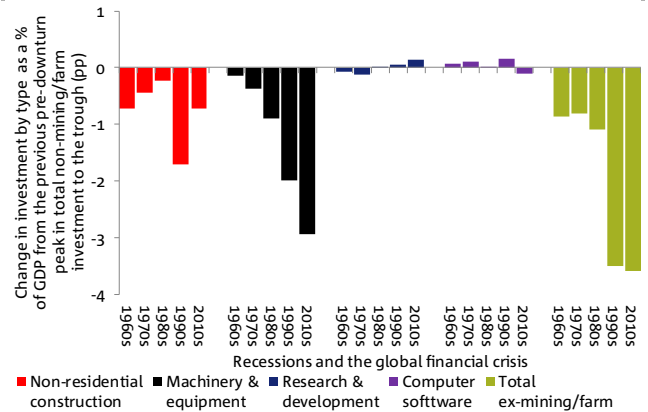
**Business investment is also weak by international standards**

Business investment is also weak by international standards. Comparing Australia and the US, investment tumbled in both countries after the global financial crisis, although the decline was larger in the US given that the crisis marked a severe recession for that country. That is, non-mining/farm, business investment fell by about 5% of GDP in the US, while the decline in Australia was about 3%. Since that point, the US has recovered about two-thirds of the loss, rebounding by over 3% of output. This compares with a small recovery in Australia of about 1% of GDP.

**The weak recovery in business investment reflects extraordinarily weak machinery and equipment**

Analysing the behaviour of non-mining/farm investment around past recessions and the global financial crisis, the mediocre recovery to date has been driven by machinery and equipment and, to a much lesser extent, research and development. That is, non-residential construction and computer software have rebounded strongly over recent years, but machinery and equipment has languished and research and development has fallen.

Chart 6: Machinery and equipment and research & development have failed to rebound from the global financial crisis

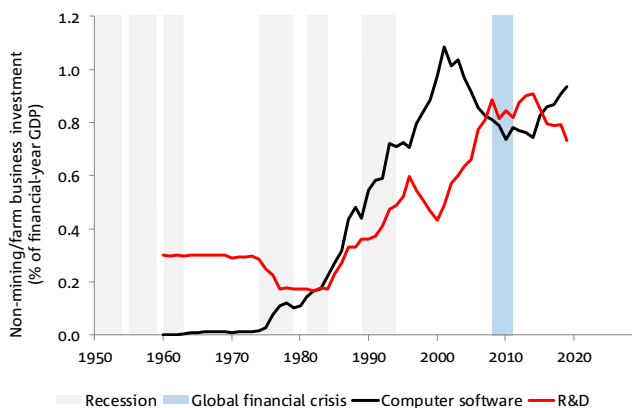
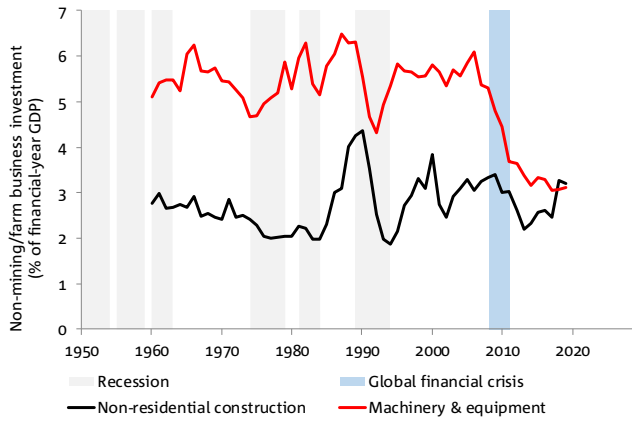


Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

**The weak recovery in investment to date reflects widespread weakness in machinery and equipment**

Machinery and equipment dominates non-mining/farm business investment and there is no parallel for the recent weakness in the post-WW2 period. Historically, machinery and equipment investment has averaged 5.5% of GDP, but in recent years it has been stuck at just above 3% of output.

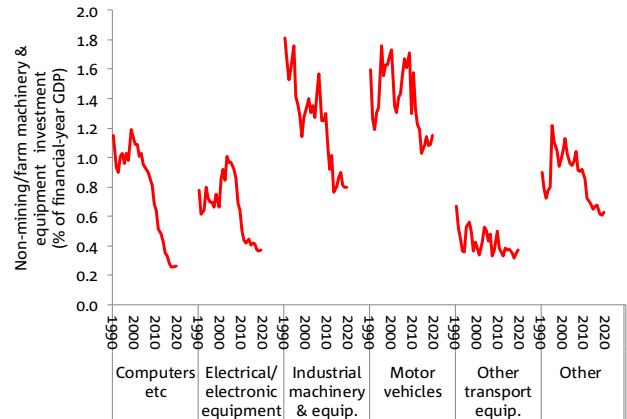
**Chart 7: Machinery and equipment is languishing**



Source: Australian Bureau of Statistics, Melbourne Institute, National Australia Bank

Data on the asset split of non-mining/farm machinery and equipment are unfortunately unavailable for the private sector, but statistics that include part of the public sector show weakness across the board.<sup>1</sup> That is, all the major components of machinery and equipment investment are currently either at or near post-WW2 lows as a share of GDP.

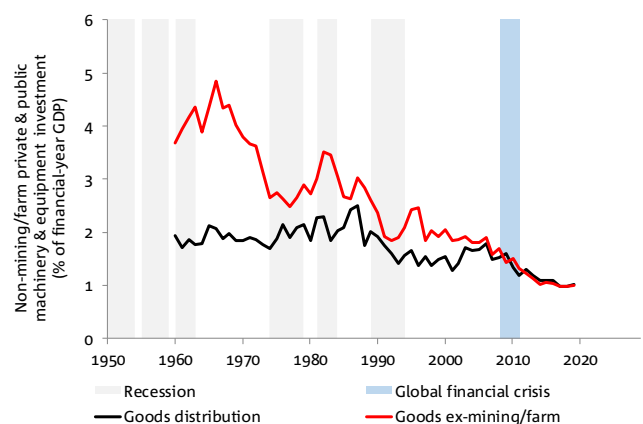
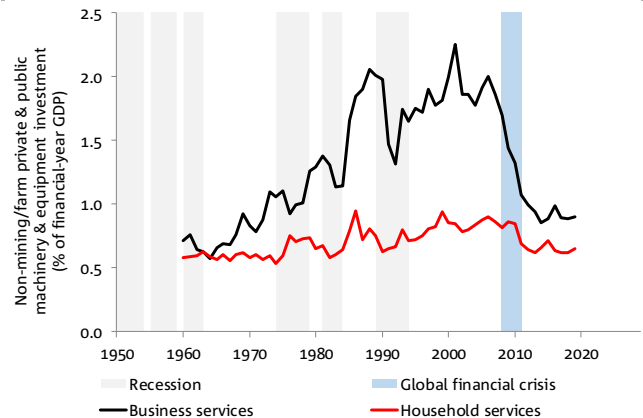
**Chart 8: The weakness in machinery and equipment is across the board by type of investment**



Note: Includes some public-sector investment.  
Source: Australian Bureau of Statistics, National Australia Bank

Taking a similar approach to the private-sector split of machinery and equipment investment by industry, the data show widespread weakness.<sup>2</sup> Notably, manufacturing, transport and storage and real estate services are particularly weak.

**Chart 9: The industry split of machinery and equipment investment shows widespread weakness in recent years**



Note: Includes some public-sector investment.  
Source: Australian Bureau of Statistics, National Australia Bank

<sup>1</sup> Due to data constraints we were only able to exclude public administration and safety from the analysis.

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**A turnaround in investment hinges on a recovery in demand and/or tax incentives**

The depth, breadth and persistence of the weakness in machinery and equipment investment by both type of spending and industry is unprecedented in the post-WW2 period and explains most of the weakness in non-mining/farm business investment.

Given investment is a key driver of productivity, the weakness in business spending points to subpar growth in both productivity and potential growth, which points to an extended period of low neutral interest rates.

Investment is not particularly sensitive to interest rates, such that a turnaround in spending is likely to prove

elusive until the Reserve Bank can engineer a recovery in consumer-led demand. That said, it would still be helpful if firms reduced hurdle rates of return on new projects.

Alternatively, the government could assist a turnaround in investment via tax incentives. The treasurer has signalled that the government may increase the depreciation allowance for investment in the May budget, although the boost to spending will be limited unless the government drops its surplus objective.

**Kieran Davies**

# CALENDAR OF ECONOMIC RELEASES

Country	Economic Indicator	Period	Forecast	Consensus	Actual	Previous	GMT	AEDT
<b>Monday 04 November 2019</b>								
GE	Markit/BME Germany Manufacturing PMI	Oct F		--		41.9	8.55	19.55
EC	Markit Eurozone Manufacturing PMI	Oct F		--		45.7	9.00	20.00
US	Durable Goods Orders	Sep F		--		-1.1	15.00	2.00
US	Factory Orders	Sep		-0.5		-0.1	15.00	2.00
<b>Tuesday 05 November 2019</b>								
AU	AiG Perf of Services Index	Oct		--		51.5	21.30	8.30
US	Fed's Daly speaks in New York						22.00	9.00
NZ	ANZ Commodity Price	Oct		--		0	0.00	11.00
CH	Caixin China PMI Services	Oct		51.5		51.3	1.45	12.45
AU	RBA Cash Rate Target	Nov 5	0.75	0.75		0.75	3.30	14.30
AU	RBA Statement on the Conduct of Monetary Policy							14.30
US	Trade Balance	Sep		-54		-54.9	13.30	0.30
US	Markit US Services PMI	Oct F		--		51	14.45	1.45
US	ISM Non-Manufacturing Index	Oct		53.9		52.6	15.00	2.00
US	Fed's Kaplan speaks in Dallas						17.40	4.40
<b>Wednesday 06 November 2019</b>								
NZ	Dairy Auction Avg. Winning Price MT	Nov 5		--		3330		early am
NZ	Unemployment Rate	3Q	4.1	4.1		3.9	21.45	8.45
NZ	Employment Change QoQ	3Q	0.3	0.2		0.8	21.45	8.45
NZ	Average Hourly Earnings QoQ	3Q	1.1	1		1.1	21.45	8.45
US	Fed's Kashkari speaks in Minneapolis						23.00	10.00
GE	Factory Orders MoM	Sep		--		-0.6	7.00	18.00
GE	Markit Germany Services PMI	Oct F		--		51.2	8.55	19.55
EC	Retail Sales YoY	Sep		--		2.1	10.00	21.00
US	Fed's Evans speaks in New York						13.00	0.00
US	Fed's Williams speaks in Q&A at Rutgers						14.50	1.30
US	Fed's Harker speaks on innovation and future of work						20.15	7.15
<b>Thursday 07 November 2019</b>								
AU	AiG Perf of Construction Index	Oct		--		42.6	21.30	8.30
AU	Trade Balance	Sep	5100	5125		5926	0.30	11.30
GE	Industrial Production WDA YoY	Sep		--		-4	7.00	18.00
UK	Bank of England Bank Rate	Nov 7	0.75	0.75		0.75	12.00	23.00
UK	BOE Asset Purchase Target	Nov		--		435	12.00	23.00
US	Fed's Kaplan speaks in Dallas						18.05	5.05
<b>Friday 08 November 2019</b>								
CH	Trade Balance	Oct		40		39.65		
CH	Exports YoY	Oct		-4.5		-3.2		
CH	Imports YoY	Oct		-8		-8.5		
US	Fed's Bostic speaks in New York on monetary policy						0.10	11.10
AU	Home Loans MoM	Sep	0.5	1.4		0.7	0.30	11.30
AU	RBA Statement on Monetary Policy						0.30	11.30
CA	Net Change in Employment	Oct		--		53.7	13.30	0.30
CA	Unemployment Rate	Oct		--		5.5	13.30	0.30
US	U. of Mich. Sentiment	Nov P		95		95.5	15.00	2.00
US	U. of Mich. Expectations	Nov P		--		84.2	15.00	2.00
US	Wholesale Inventories MoM	Sep F		--		-0.3	15.00	2.00
<b>Upcoming Central Bank Interest Rate Announcements</b>								
Australia, RBA		Nov 5	0.75	0.75		0.75		
Europe, ECB		Dec 12	-0.50	-0.50		-0.50		
Japan, BoJ		Oct 31	-0.10	-0.10		-0.10		
New Zealand, RBNZ		Nov 13	1.00	1.00		1.00		
UK, BOE		Nov 7	0.75	0.75		0.75		
US, Federal Reserve		Dec 11	1.5/1.75	1.5/1.75		1.5/1.75		

GMT: Greenwich Mean Time; AEDT: Australian Eastern Daylight Time

# FORECASTS

Economic Forecasts																				
	Annual % change				Quarterly % change															
	2018	2019	2020	2021	2018				2019				2020				2021			
Australia Forecasts	2018	2019	2020	2021	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Household Consumption	2.6	1.4	1.7	2.3	0.5	0.8	0.3	0.4	0.3	0.4	0.3	0.3	0.4	0.5	0.6	0.5	0.6	0.6	0.6	0.6
Underlying Business Investment	1.2	-2.1	0.2	1.9	0.7	-0.8	-2.1	0.1	-0.2	-0.6	-0.3	-0.5	0.1	0.1	1.1	0.5	0.4	0.4	0.2	0.4
Residential Construction	4.8	-8.6	-8.1	-0.9	3.3	2.8	0.1	-2.8	-2.2	-4.4	-2.7	-2.4	-2.1	-1.3	-1.7	-0.5	0.1	0.2	0.5	0.8
Underlying Public Spending	4.3	4.2	3.8	3.6	1.4	-0.1	2.1	0.8	1.1	1.4	0.4	0.8	1.1	1.1	0.9	0.9	0.8	0.8	0.8	0.9
Net Exports (a)	0.8	1.6	-0.1	-0.2	0.6	0.0	0.4	-0.2	0.4	0.6	0.3	0.3	0.0	0.0	-0.1	0.0	0.0	0.0	-0.1	0.0
Inventories (a)	0.1	-0.4	0.1	0.1	0.0	0.2	-0.3	0.2	-0.1	-0.5	0.0	0.1	0.1	0.0	0.1	0.0	0.0	0.0	0.0	0.0
Domestic Demand (q/q %)	-	-	-	-	0.9	0.5	0.4	0.2	0.1	0.3	0.2	0.2	0.5	0.5	0.6	0.6	0.7	0.7	0.7	0.7
Dom Demand (y/y %)	2.8	0.9	1.7	2.6	3.5	3.3	2.5	2.0	1.2	1.0	0.8	0.8	1.2	1.4	1.9	2.2	2.5	2.6	2.7	2.8
Real GDP (q/q %)	-	-	-	-	1.0	0.7	0.3	0.1	0.5	0.5	0.5	0.5	0.6	0.5	0.7	0.6	0.6	0.6	0.6	0.7
Real GDP (y/y %)	2.7	1.7	2.2	2.5	3.1	3.1	2.6	2.2	1.7	1.4	1.6	2.0	2.1	2.1	2.3	2.4	2.4	2.6	2.5	2.6
CPI headline (q/q %)	-	-	-	-	0.4	0.4	0.4	0.5	0.0	0.6	0.4	0.6	0.4	0.4	0.5	0.7	0.5	0.5	0.6	0.7
CPI headline (y/y %)	1.9	1.5	1.8	2.2	1.9	2.1	1.9	1.8	1.3	1.6	1.6	1.6	2.0	1.7	1.8	1.9	2.0	2.1	2.3	2.3
CPI underlying (q/q %)	-	-	-	-	0.5	0.5	0.4	0.4	0.2	0.4	0.4	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5	0.5
CPI underlying (y/y %)	1.9	1.4	1.5	1.9	1.9	1.9	1.8	1.8	1.5	1.4	1.4	1.3	1.5	1.5	1.5	1.6	1.7	1.9	2.0	2.0
Private wages (q/q %)	-	-	-	-	0.5	0.6	0.5	0.6	0.5	0.5	0.6	0.6	0.7	0.7	0.7	0.7	0.7	0.7	0.7	0.7
Private wages (y/y %)	2.1	2.3	2.5	2.8	1.9	2.1	2.1	2.3	2.4	2.3	2.3	2.3	2.4	2.5	2.6	2.6	2.7	2.7	2.8	2.8
Unemployment Rate (%)	5.3	5.2	5.4	5.5	5.5	5.6	5.1	5.0	5.0	5.2	5.2	5.3	5.3	5.4	5.5	5.5	5.5	5.4	5.4	5.4
Terms of trade	2.0	3.2	-7.9	1.8	3.3	-1.3	1.1	3.0	3.1	1.5	-4.4	-4.7	-2.6	-0.6	0.9	-0.2	1.2	0.6	-0.1	-0.1
Current Account (% GDP)	-2.1	0.3	-1.0	-0.8	-2.2	-2.7	-2.2	-1.4	-0.2	1.2	0.5	-0.3	-0.9	-1.1	-1.0	-1.0	-0.8	-0.7	-0.8	-0.9

Source: NAB Group Economics; (a) Contributions to GDP growth

## Exchange Rate Forecasts

	4-Nov	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
<b>Majors</b>						
AUD/USD	0.692	0.65	0.66	0.67	0.69	0.70
NZD/USD	0.65	0.62	0.62	0.63	0.65	0.65
USD/JPY	108.2	104	104	105	106	106
EUR/USD	1.12	1.12	1.11	1.13	1.14	1.15
GBP/USD	1.29	1.20	1.18	1.20	1.22	1.24
USD/CNY	7.03	7.40	7.40	7.30	7.20	7.10
USD/CAD	1.31	1.36	1.38	1.38	1.36	1.35
USD/CHF	0.99	0.97	0.95	0.96	0.96	0.96

## Australian Cross Rates

AUD/NZD	1.07	1.05	1.06	1.06	1.06	1.08
AUD/JPY	74.9	68	69	70	73	74
AUD/EUR	0.62	0.58	0.59	0.59	0.61	0.61
AUD/GBP	0.53	0.54	0.56	0.56	0.57	0.56
AUD/CNY	4.86	4.81	4.88	4.89	4.97	4.97
AUD/CAD	0.91	0.88	0.91	0.92	0.94	0.95
AUD/CHF	0.68	0.63	0.63	0.64	0.66	0.67

## Interest Rate Forecasts

	4-Nov	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20
<b>Australian Rates</b>						
RBA cash rate	0.75	0.50	0.50	0.50	0.50	0.50
3 month bill rate	0.93	0.60	0.60	0.60	0.60	0.60
3 Year Swap Rate	0.89	0.70	0.70	0.85	0.95	1.00
10 Year Swap Rate	1.36	1.05	1.05	1.20	1.35	1.45
<b>Offshore Policy Rates</b>						
US Fed funds	1.75	1.75	1.75	1.75	1.75	1.75
ECB deposit rate	-0.50	-0.60	-0.70	-0.70	-0.70	-0.70
BoE repo rate	0.75	0.75	0.75	0.75	0.75	1.00
BoJ excess reserves rate	-0.10	-0.20	-0.20	-0.30	-0.30	-0.30
RBNZ OCR	1.00	0.75	0.50	0.50	0.50	0.50
China 1yr lending rate	4.35	4.10	4.10	4.10	4.10	4.10
China Reserve Ratio	13.0	12.50	12.00	12.00	12.00	12.00
<b>10-year Bond Yields</b>						
Australia	1.17	0.90	0.90	1.00	1.10	1.20
United States	1.71	1.50	1.50	1.60	1.70	1.80
New Zealand	1.32	0.95	0.95	1.05	1.10	1.30

Sources: NAB Global Markets Research; Bloomberg; ABS

## Global GDP

	2018	2019	2020	2021
Australia	2.7	1.7	2.2	2.5
United States	2.9	2.2	1.6	1.8
Eurozone	1.9	1.1	1.1	1.4
United Kingdom	1.4	1.2	1.2	1.5
Japan	0.8	1.0	0.2	0.9
China	6.6	6.3	6.0	5.8
India	6.8	5.7	6.8	7.1
New Zealand	2.9	2.1	2.4	2.0
World	3.6	3.1	3.2	3.5

## Commodity prices (\$US)

	4-Nov	Dec-19	Mar-20	Jun-20	Sep-20
Brent oil	61.4	70	70	75	75
Gold	1512	1450	1483	1518	1547
Iron ore	na	76	72	68	71
Hard coking coal*	137	170	165	160	155
Thermal coal	70	90	93	90	88
Copper	5827	6300	6225	6150	6125
Aus LNG**	10	12	12	12	12

\* FOB quarterly contract prices (thermal coal is JFY contract)

\*\* Implied Australian LNG export prices

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